United States General Accounting Office

GAO Report to Congressional Committees

DOD CONTRACTING

Techniques to Ensure Timely Payments to Subcontractors

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National Security and
International Affairs Division

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The Honorable Sam Nunn
Chairman, Committee on
Armed Services
United States Senate

The Honorable Dale Bumpers
Chairman, Committee on
Small Business
United States Senate

The Honorable Ronald V. Dellums
Chairman, Committee on
Armed Services
U.S. House of Representatives

The Honorable John J. LaFalce
Chairman, Committee on
Small Business
U.S. House of Representatives

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We identified existing statutory and regulatory provisions that help provide timely payments to subcontractors working on federal contracts and evaluated the feasibility and desirability of additional payment protections for subcontractors working on federal projects.

We are sending copies of this report to the Secretaries of Defense, Air Force, Army, and Navy; the Director, Office of Management and Budget; and other interested parties. Upon request, copies may also be made available to others.

This report was prepared under the direction of Paul F. Math, Director, Acquisition Policy, Technology, and Competitiveness, who may be reached on (202) 512-4587 if you or your staff have any questions concerning this report. Other major contributors are listed in appendix VI.

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Executive Summary

Purpose

Subcontractors depend on cash flow generated by progress or other periodic payments from prime contractors to meet payrolls and pay other bills. A long-standing congressional concern is whether federal prime contractors are paying subcontractors in a timely manner. Payments to subcontractors sometimes constitute well over 50 percent of prime contract costs.

This report responds to section 806 of the National Defense Authorization Act for Fiscal Years 1992 and 1993, which requires GAO to (1) identify existing statutory and regulatory provisions that help provide timely payments to subcontractors working on federal contracts and (2) evaluate the feasibility and desirability of additional proposed payment protections for subcontractors that are enumerated in the legislation.

Background

The federal government provides interim financing to prime contractors. On fixed-price contracts, the government uses progress payments, which can reimburse contractors for 75 to 100 percent of allowed incurred costs each month. On cost-reimbursement contracts, the government can reimburse contractors for all allowable incurred costs on a biweekly basis. Under both types of contracts, the prime contractors' payment requests to the government will often include costs incurred to pay subcontractors.

Prime contractors have primary responsibility for managing payments to subcontractors. Although the federal government has concerns about payment protection for subcontractors, the government does not have a contractual relationship with the subcontractors. As a result, the federal government has been a reluctant participant in resolving payment problems between its prime contractors and their subcontractors.

Results in Brief

Various statutory and regulatory provisions provide payment protection for federal subcontractors. These provisions vary depending on the type of contract and contractor. While the proposals listed for evaluation in section 806 would provide additional payment protections, in most cases, they would add varying amounts of cost and administrative burdens to the government's and contractors' payment processes.

GAO contacted the industrial associations that previously reported that subcontractor payment problems were prevalent, as well as other associations, to distribute a questionnaire, presuming that if problems exist, firms would notify GAO in their responses. GAO received 151 responses from subcontractors that complained about their payment problems on work funded by federal projects in fiscal year 1991 (their latest complete fiscal year). The identified payment problems were noteworthy to the responding subcontractors because they adversely affected the firms' cash flow and financial health. GAO could not use statistical sampling techniques because a complete data base on subcontractors does not exist. Because of this and the fact that the respondents were entirely self-selected, GAO could not determine whether the responding subcontractors are representative of subcontractors generally.

The proposals for consideration in section 806 would not necessarily resolve all subcontractors' payment problems. For example, the proposals will not eliminate delayed payments to subcontractors that result from disputes. When specifically needed, most of the items listed in section 806 could currently be used by contracting officers on an ad hoc basis. However, federal policy and procedures do not describe the circumstances under which contracting officers should take action to use these techniques to ensure timely payments to subcontractors.

Principal Findings

Subcontractor Payment Protection Provided

A number of existing statutes and regulations provide payment protection to subcontractors. For example, large business prime contractors working on non-construction projects are required to pay subcontractors before billing the government. In contrast, prime contractors working on federal construction projects are allowed to bill the government before paying their subcontractors. However, they are required to pay their subcontractors within 7 days after receiving payment from the government and certify that they will make timely payment to their subcontractors. These additional payment protections for subcontractors working on federal construction projects were enacted in 1988 as amendments to the Prompt Payment Act, partly because payment problems were reported to be prevalent.

The payment protections enumerated in section 806 are generally feasible and many are currently being used on a limited, ad hoc basis by contracting officers. However, statutory and regulatory provisions requiring the routine use of these payment protections would add to costs and administrative burdens by requiring additional data, procedures, and controls.

Payment Problems Identified by 151 Subcontractors

A GAO questionnaire to obtain information from subcontractors about their payment problems was distributed through 33 contractor associations and other means. GAO received 151 responses from subcontractors that complained about their payment problems on work funded by federal projects in fiscal year 1991 (their latest complete fiscal year). Of the 151 subcontractors that complained about late payment, 118 reported the amounts of delayed payments. The delayed payments were estimated at $345 million, or about 23 percent of subcontract revenue, and the delays averaged 146 days from the time the subcontractors submitted their invoices to the prime contractors.

Contracting Officers Could Provide Added Payment Protection

Contracting officers have occasionally used existing authority to make special arrangements to improve the timeliness of payments to subcontractors. However, substantial evidence of a payment problem is needed before they initiate additional payment protection for subcontractors, which can be a time-consuming process. Contracting officials expressed a reluctance to take actions even in cases where contract performance had been significantly affected or the contractor had repeatedly failed to make timely payments. Department of Defense (DOD) officials stated that existing policy and procedures do not clearly state when a contracting officer should act and what actions should be taken when subcontractor payment problems are identified.

Recommendation

GAO recommends that the Secretary of Defense issue policies and procedures for (1) identifying the circumstances under which contracting officers should take action to provide payment protection for subcontractors and (2) implementing appropriate payment protection techniques.

Comments and GAO's Evaluation

In commenting on a draft of this report, DOD concurred with its findings and partially concurred with its recommendation. DOD stated that it has a significant interest in the timely payment of subcontractors because of the potential negative impact on a prime contractor's performance when subcontractors are not paid promptly. DOD agreed to take action to ensure that contracting officers are aware of the special techniques to use when subcontractor payment problems arise. GAO believes that DOD's proposed actions are consistent with its recommendation.

DOD's comments are presented in their entirety in appendix I.

GAO also received comments on a draft of this report from selected industrial associations and has revised the report where appropriate. While several industrial associations were supportive of GAO's findings, some were critical of several aspects of GAO's draft report. One of the criticisms indicated that GAO did not fulfill the requirements of section 806, in part, because it did not include an analysis of the appropriateness of any differential treatment needed in exploring the feasibility and desirability of the payment protections described in section 806. GAO considered the feasibility and desirability of providing additional payment protection for subcontractors working for different categories of prime contractors, as well as providing additional payment protection for all tiers of subcontractors. However, GAO concluded that since the payment problems identified were not specific to a particular group, there was not a need for providing differential treatment.

Other criticisms centered around the distribution of the questionnaire contained in appendix III, as well as the time provided to respond to the questionnaire. GAO has modified its report to emphasize that it did not use statistical sampling techniques and that the respondents were entirely self-selected. GAO had originally requested that all responses be returned by September 15, 1992. However, when GAO contacted each of the associations to ensure that they had received the questionnaire for distribution to their member firms, 10 of the 33 associations were given additional time to distribute the questionnaire; as a result, GAO continued to accept responses through November 1992.

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Abbreviations

DOD	Department of Defense
GAO	General Accounting Office
OMB	Office of Management and Budget
SBA	Small Business Administration

Introduction

In fiscal year 1991, the federal government reported contracting actions for goods and services totaling about $210 billion, with payments to subcontractors representing a large portion of these dollars.[1] These payments to subcontractors sometimes constitute well over 50 percent of prime contract costs. Late payments can adversely affect prime contractors' and subcontractors' financial health. In 1982, the Congress enacted the Prompt Payment Act, which requires federal agencies to pay their bills on time or pay interest on payments made to contractors after the due date.

Prime contractors may receive progress or other payments from the government for both fixed-price contracts and cost-reimbursement contracts.[2] Prime contractors, in turn, may make progress or other payments to their subcontractors. Progress payments are a method of interim contract financing on fixed-price contracts in which the government and the contractor share the financial burden of contract performance. The government can reimburse the contractor through progress payments of 75 to 100 percent of allowed incurred costs each month. On cost-reimbursement contracts, the government can reimburse the contractor for all allowable incurred costs on a biweekly basis. A substantial portion of the prime contractor's payment request to the government will often include costs incurred to pay subcontractors.

Prime contractors have primary responsibility for managing payments to subcontractors. Although the federal government has concerns about payment protection for subcontractors, the government does not have a contractual relationship with the subcontractors. As a result, the federal government has been a reluctant participant in resolving payment problems between its prime contractors and their subcontractors.

Large business prime contractors working on non-construction projects receiving interim payments provide payment protection to their subcontractors because they are required to make payment to subcontractors before billing the government. In contrast, all small business[3] prime contractors, as well as large business primes working on a

[1] "Subcontractor" is used throughout this report to refer to any supplier, distributor, vendor, or firm that furnishes supplies or services to or for a prime contractor or another subcontractor.

[2] A fixed-price contract provides for a firm pricing arrangement established by the parties at the time of contract award. A cost-reimbursement contract provides for payment to the contractor of allowable incurred costs of performing the contract.

[3] A small business in federal contracting must conform to the government's size standards for small in its industry. The standards relate to the number of employees or dollar amounts in annual receipts.

federal construction project, are allowed to bill the government before paying their subcontractors.

During congressional hearings in 1987 and 1988, evidence was presented on substantial abuses involving construction contractors not paying subcontractors on time, which was affecting the government's ability to obtain performance on these construction contracts. Subcontractors depend on cash flow generated by progress or other payments to meet payrolls and pay other bills. Subcontractors usually perform as much as 50 percent of work on federal construction projects. The Congress responded to the payment problem by adding new provisions to the Prompt Payment Act that apply to all subcontractors under federal construction contracts. Under these provisions, certain contract clauses must be included in all construction contracts and subcontracts. Members of Congress have continued to express concern regarding the timeliness of progress payments and other payments to subcontractors working for federal prime contractors.

Objectives, Scope, and Methodology

The National Defense Authorization Act for Fiscal Years 1992 and 1993, section 806, required us to (1) identify existing statutory and regulatory provisions which help provide timely payment of progress or other periodic payments to subcontractors by prime contractors on federal contracts and (2) evaluate the feasibility and desirability of requiring additional protections to ensure the timely payment of progress or other periodic payments, including the following protections:

- Fixed-payment terms and certification. A prime contractor (other than construction prime contractor) would be required to (1) include in its subcontracts a payment term requiring payment within 7 days (or some other fixed term) after the prime receives payment from the government and (2) submit with its payment request to the government a certification that payments to subcontractors have been made from previous payments received under contract, and timely payments will be made from the proceeds of the payment covered by this certification.
- Proof of payment. All prime contractors (other than construction prime contractors subject to the provisions of sections 3903(b) and 3905 of title 31, United States Code) would be required to furnish with their payment request to the government proof of payment of the amounts included in such payment request for payments made to subcontractors.
- Escrow accounts. A prime contractor would be required to establish an escrow account at a federally insured financial institution that would

make direct disbursements to subcontractors for the amounts certified by the prime contractor in its payment request to the government as being payable to such subcontractors in accordance with their subcontracts.

- Direct disbursement when needed. If the contracting officer determines that the prime contractor is failing to make timely payments to its subcontractors, require direct disbursement of amounts certified by a prime contractor as being payable to its subcontractors in accordance with their subcontracts (using techniques such as joint payee checks, escrow accounts, or direct payment by the government).

In addition, the act required us to consider the following protections:

- Using payment bonds to ensure timely and ultimate payment. Prime contractors would be required to obtain payment bonds, pursuant to the Miller Act as a means of affording protection to construction subcontractors, to help ensure (1) timely payment of progress payments and (2) ultimate payment of such amounts due.
- Increasing payment bonds to equal 100 percent of the contract value. Payment bond amounts required under the Miller Act would be increased from the current maximum amounts to an amount equal to 100 percent of the amount of the contract.
- Requiring payment bonds for supply and service contracts. Payment bonds would be required for supply and service contracts (other than construction) and, if feasible and desirable, the amounts of such bonds.
- Using letters of credit as substitutes for payment bonds. Letters of credit issued by federally insured financial institutions (or other alternatives) would be used as substitutes for payment bonds in providing protection to subcontractors on federal contracts.

The act also requested that we evaluate the effectiveness of the modifications to federal regulations relating to the use of individual sureties. However, we did not incorporate this as part of our evaluation because we had recently issued a report stating that the changes to regulations to curtail abuse by individual sureties were a step toward strengthening management controls over individual sureties.[4]

To identify existing statutory and regulatory provisions that help provide timely payment of progress or other periodic payments to subcontractors, we reviewed the Federal Acquisition Regulation and regulations issued by individual agencies. We discussed specific provisions that provide

[4] Construction Contracts: Individual Sureties Had No Defaults on Fiscal Year 1991 Contracts (GAO/GGD-92-60, Apr. 1, 1992).

payment protections with legal, policy, and contract management officials and others. We conducted a computerized search of data bases containing federal laws and regulations. In addition, we obtained and discussed pertinent agency guidance.

We interviewed officials at numerous executive branch activities (see app. II for a listing of the activities and locations we visited), subcontractors, and prime contractors to (1) explore the feasibility and desirability of additional payment protection provisions for subcontractors, (2) identify examples where executive agencies have had experience using the type of payment protection provisions listed in section 806, and (3) identify whether alternative provisions for protecting subcontractors would be more feasible and desirable. We interviewed officials at large banks, sureties, and banking and surety associations to better evaluate the feasibility and desirability of the suggested payment protection provisions.

As part of our effort to assess the desirability of additional payment protection for subcontractors on federal projects, we developed a questionnaire, reprinted in appendix III, to identify problems subcontractors have experienced in receiving payments from work funded by federal projects in fiscal year 1991 (their latest complete fiscal year at the time the questionnaire was issued). The questionnaire was developed during pretests with subcontractors.

A complete data base on subcontractors working on federal projects does not exist; therefore, we could not specify the extent of payment problems experienced by all subcontractors working on federal projects. We contacted the industrial associations that previously have reported that subcontractor payment problems were a common occurrence, as well as other associations, to distribute the questionnaire presuming that if problems exist, firms would notify us. Seventy-eight industrial associations were asked to distribute our questionnaire to their member firms. The list of associations was compiled, in part, by consulting with congressional staff and those associations who had previously reported on subcontractor payment problems. (See app. IV for a listing of the 33 trade associations that agreed to distribute our questionnaire.) The trade associations either sent a copy of the entire questionnaire to their members or provided their members with the opportunity to request a copy. Many of the associations sent cover letters to their member firms to encourage the firms to respond to the questionnaire. We had originally requested that all responses be returned by September 15, 1992. However, when we contacted each of the associations to ensure that they had received our questionnaire for distribution to their member firms, 10 of the 33 associations were given additional time to distribute the questionnaire. As a result, we continued to accept responses through November 1992.

In addition, the questionnaire was published in its entirety in both the Federal Register and the Government Contracts Reports. Five other publications (Commerce Business Daily, Contract Management, Federal Acquisition Report, Federal Computer Week, and the Federal Contracts Report) printed notices about the questionnaire for subscribers. The publications provided readers with a telephone number to obtain additional information on the study. Ninety-two questionnaires were sent directly to subcontractors.

Because we did not use statistical sampling techniques and the respondents were entirely self-selected, we could not determine whether these subcontractors are representative of subcontractors generally. In addition, the information we gathered could not be used to determine the relative magnitude or types of payment problems for subcontractors generally or for any particular subgroup of contractors.

We interviewed selected subcontractors responding to our questionnaire as well as some of their prime contractors to obtain a more complete perspective on the payment problems being experienced by subcontractors. However, we did not verify the accuracy of the information provided to us from subcontractors experiencing late payments.

We performed our work from February 1992 to January 1993 in accordance with generally accepted government auditing standards.

Chapter 2

Comparison of Existing Subcontractor Payment Protection Provisions With Section 806 Provisions

Statutory and regulatory provisions currently provide payment protections for subcontractors working on federal projects. In most cases, the proposals in section 806 would provide additional payment protections, but would add varying amounts of cost and administrative burdens to the government's and contractors' payment processes. Furthermore, most of these provisions are being used by contracting officers on a limited basis if contract performance is adversely affected by payment problems between the prime contractor and its subcontractors.

Table 2.1 compares payment protections that currently exist with the proposed payment protections listed in section 806. The discussion that follows the table highlights how the items listed in section 806 would supplement existing payment protections provided by laws and regulations. In addition to the payment protections described in table 2.1, federal regulations require government officials to determine whether prospective contractors are financially capable before awarding contracts and regulations also require reviews or audits of prime contractors after paying them, in part, to determine whether they pay their bills on time. (See app. V for a listing of statutory and regulatory provisions to help ensure payments to subcontractors.)

Table 2.1: Comparison of Existing Payment Protection Provisions With Section 806 Proposed Provisions

Section 806 proposed payment protection provisions	Existing requirement: Construction	Existing requirement: Non-construction	Proposed provisions: Construction	Proposed provisions: Non-construction
Fixed-payment term and certification: Prime contractor must (1) include a clause in subcontracts requiring payment within a fixed time period after receiving payment from the government and (2) certify with each invoice that past subcontractor payments have been made on time and that payments covered by the certified invoice will be made on time.	Yes	No	a	Yes
Proof of payment: Prime contractor must have paid and submitted proof of payments to subcontractors when invoicing the government for those payments.	No	No	No	Yes
Escrow accounts: Prime contractor must establish an escrow account and require disbursements by the escrow agent of amounts certified by the prime contractor in invoices to the government as being payable to subcontractors.	No	No	Yes	Yes
Direct disbursement when needed: If a government contracting officer determines the prime is not making timely payments, require direct disbursements to subcontractors of amounts certified by the prime contractor in invoices to the federal government as being payable to its subcontractors (using techniques such as joint payee checks, escrow accounts, or direct payment by the government).	Currently permitted	Currently permitted	Yes	Yes
Payment bonds for ultimate payment: Prime contractor must furnish a payment bond to ensure ultimate payment.	Currently required on contracts exceeding $25,000	No	a	Yes
Payment bonds for timely payment: Prime contractor must furnish a payment bond to ensure timely payment.	No	No	Yes	No
Payment bonds to equal contract value: For construction contracts that require the prime contractor to furnish a payment bond, the amount of the bond must be equal to 100 percent of contract amount.	No	No	Yes	No
Payment bonds on supply and service contracts: Prime contractors would be required to obtain payment bonds.	No	No	No	Yes
Letters of credit as substitutes for payment bonds: Prime contractor is permitted to substitute letters of credit for payment bonds.	Currently pending	No	Yes	Yes

[a]The proposed provision does not indicate that the existing requirement would be changed.

Fixed-Payment Term and Certification

Section 806 lists as an option for consideration that a prime contractor (other than a construction prime contractor) be required to include in its subcontracts a fixed-payment term after the prime receives payment from the government and to certify that it will make timely payments to subcontractors. Federal regulations, however, require large business non-construction prime contractors to pay their subcontractors before receiving payment from the government. Accordingly, to be an effective mechanism for ensuring timely payment to subcontractors, this proposal, if implemented, should be applicable only to prime contractors that pay their subcontractors after receiving payment from the federal government.

In 1988, the Prompt Payment Act was amended to provide payment protections for subcontractors working on federal construction projects. The act as implemented requires prime contractors (1) to pay subcontractors within 7 days of receiving payment or pay interest on late payments and (2) to certify the following:

"Payments to subcontractors . . . have been made from previous payments received under the contract, and timely payments will be made from the proceeds of the payment covered by this certification, in accordance with subcontract agreements and the requirements of chapter 39 [Prompt Payment] of Title 31, United States Code . . ."

The act also requires that subcontractors working on federal construction projects pay lower tier subcontractors within 7 days of receiving payment or pay interest on late payments. Subcontractors are to use the same fixed-payment term and interest penalty clauses in lower tier subcontracts that prime contractors must use. Other Prompt Payment Act requirements supplement the fixed payment term, interest penalty, and prime contractor's certification. Federal agencies are required to obtain detailed information from prime contractors working on federal construction projects on amounts owed and paid to individual subcontractors with each request for payment and certification. This requirement is intended to deter prime contractors on federal construction projects from (1) certifying and submitting fraudulent payment requests or (2) diverting government payments for other purposes besides paying subcontractors.

All large business non-construction prime contractors for both fixed-type and cost-reimbursement contracts are required to pay their subcontractors before receiving payment from the government. In addition, both large business and small business, non-construction prime contractors with fixed-price contracts and progress payments must certify on the form used to bill the government that

"... all the costs of contract performance ... have been paid to the extent shown [on the request for payment], or when not shown as paid have been paid or will be paid currently, by the contractor, when due, in the ordinary course of business ..."

Prime contractors with cost-reimbursement contracts are not required to certify or sign the form used to bill the government.

Proof of Payment

Section 806 lists as an option for consideration that prime contractors (other than construction) would be required to furnish with their payment request to the government proof of payments made to subcontractors. Proof of payment, such as canceled checks, would document that prime contractors had paid the costs of subcontracts in advance of billing the government or shortly thereafter.

Under current regulations, small business primes can receive payment for subcontractor costs that they have incurred but not yet paid. If proof of payment was used on all contracts, as stated in section 806, the current differential treatment that provides a financial benefit to small businesses receiving contract financing would be eliminated. Unless there is a desire to eliminate this differential treatment, small business primes could be excluded from this provision.

Proof of payment is not currently required for any government contract on a routine basis but has been used on an ad hoc basis. The government has required prime contractors (other than construction) to furnish proof of payment when late payments to subcontractors have substantially hindered the performance of government contracts. For example, the Naval Sea Systems Command used a variation of proof of payment on a shipbuilding contract because the contractor had repeatedly failed to pay its subcontractors in the normal course of business, was financially insolvent, and was not making progress on the contract. The process the Navy used to administer proof of payment was as follows: (1) the contractor submitted a list of the subcontractors it planned to pay; (2) the Navy verified that the contractor planned to spend the material portion of the progress payment making subcontractor payments and then paid the prime contractor; (3) subcontractors signed certifications that they had received payment; and (4) the prime contractor submitted the certifications as proof of payment and verified that the listed subcontractors received payment. Although this process resulted in additional costs and administrative burden for the government and the contractors, it was considered necessary to ensure completion of the project.

Escrow Accounts

Section 806 lists as an option for consideration that prime contractors be required to establish an escrow account that would be used to control disbursements of contract funds and to prevent the prime contractor from diverting funds for other uses. With an escrow account in place, a third party, the escrow agent, would receive and disburse funds to subcontractors. The escrow agent rather than the prime contractor would receive payment from the government and be responsible for making payments to subcontractors in amounts certified by the prime contractor.

Escrow accounts are not currently required for government contracts on a routine basis; however, they have been used on an ad hoc basis. In one case, agency officials were repeatedly notified over a 6-month period that the prime contractor had routinely failed to make timely payments to the subcontractor. After realizing that contract performance could be in jeopardy, the contracting officer assisted the subcontractor in negotiating with the prime to obtain an escrow agreement. However, it took several additional months from when the contracting officer agreed to get involved until the escrow account became effective. When the escrow account was finally in place and the correct payment office had the paperwork, future payments were made to the escrow account as stated in the contract modification.

In addition, escrow accounts would increase contract costs to the government, with set-up fees alone ranging from $5,000 to $10,000 annually per contract, according to officials at a large bank. These officials stated that the cost of escrow accounts could be even higher depending on such factors as the frequency and volume of checks disbursed. For example, in one auxiliary ship contract, there were 186 first-tier subcontractors. Contracts for larger ships, such as an aircraft carrier, would have many more subcontractors and provide for progress payments as often as every 2 weeks for many years. A senior Naval Sea Systems Command official told us that requiring escrow accounts would be among the most expensive section 806 provisions to implement on shipbuilding contracts, and therefore, does not favor their routine use.

Direct Disbursement When Needed

Section 806 lists as an option for consideration that direct disbursement be required of amounts certified by a prime contractor as being payable to its subcontractors (using techniques such as joint payee checks, escrow accounts, or direct payment by the government), if the contracting officer determines that the prime contractor has failed to make timely payments to its subcontractors. A principal advantage of this proposal is that it is clearly intended for use on an ad hoc basis—when a problem has been identified. The purpose of direct disbursement is to prevent the prime contractor from diverting funds for other uses by placing controls on those funds. With any method of direct disbursement, the prime contractor would still be responsible for determining what amounts are payable to subcontractors.

A technique for disbursing payments for contract costs, the special bank account, has been used in the past on an ad hoc basis to help ensure contract performance. For example, when the Navy learned that a shipbuilder was having difficulty performing, it negotiated with the contractor to establish a special bank account. This allowed the shipbuilder to continue receiving progress payments. A subcontractor told us that its invoices were paid promptly once a special bank account was instituted. While special bank accounts are a satisfactory method for ensuring payment in extraordinary circumstances, officials familiar with them said they are too administratively burdensome for routine use since a government representative must review and sign each check.

In another case illustrating the use of a joint payee check arrangement, the contracting officer requested the Defense Contract Audit Agency to verify the amount of progress payments paid to subcontractors. The Defense Contract Audit Agency reviewed the prime's progress payments and discovered that the contractor delayed payment of subcontract progress billings for an unreasonable period despite having received government payment for these subcontract billings. Even after the Defense Contract Audit Agency review, the contractor continued to delay payment to subcontractors. According to the contracting officer, a joint payee check arrangement was established and was effective in ensuring subcontractors were paid in a more timely manner—but nevertheless, it was a time-consuming process.

Payment Bonds for Ultimate Payment

Section 806 lists as an option for consideration that payment bonds be used to provide subcontractors with a remedy for seeking payment if the prime contractor fails to make payment. A payment bond is a promise of a surety to assure payment to subcontractors on a contract. A surety is the individual or corporation that has agreed to be legally liable for the debt, default, or failure to satisfy a contractual obligation. The surety is legally liable for the dollar value of the payment bond. However, payment bonds would not prevent payment problems from occurring because subcontractors must demonstrate that the prime contractor has already failed to make payment.

Payment bonds have generally been required for construction contracts but not for other contracts.[1] The Miller Act, enacted in 1935, established the bonding requirements for federal construction contracts. Prime contractors on federal construction projects are required to furnish a payment bond before starting work on any contract exceeding $25,000.

On commercial construction projects, subcontractors furnishing labor or materials to a construction project have the right to file a lien to provide the subcontractor protection against nonpayment. However, subcontractors do not have lien rights with respect to federal construction projects. Instead, the prime contractor must provide a payment bond. The government will reimburse the contractor for the costs of bonding to the extent that such costs are deemed reasonable.

The Small Business Administration (SBA) has, under a pilot program, waived bonding requirements on construction contracts for small disadvantaged businesses that have not been able to obtain bonds. A special bank account is being used on a test basis as an alternative to the Miller Act payment bond for construction contracts. Under the special bank account, the government must approve all requests for disbursement, and all checks must be signed jointly by the contractor and an SBA representative or an SBA-approved third party. Use of direct disbursement instead of a special bank account is optional.

Under current regulations, the use of payment bonds is generally not required for other than construction contracts, but bonds may be used when it is deemed necessary to protect the government's interest. Bonds may be required when government property is provided to the contractor for use in performing the contract. Also, bonds may be required in other situations. The Navy experimented with the elimination of bonds on small craft procurements but reissued a policy requiring performance and

[1]Miller Act payment bonds cover subcontractors that have a contractual relationship with a prime contractor or a relationship with a first-tier subcontractor that has a contractual relationship with a prime contractor.

payment bonds after experiencing increased contractor defaults.[2] A payment bond may be required only when the government also requires the contractor to furnish a performance bond.

Payment Bonds for Timely Payment

Section 806 lists as an option for consideration that payment bonds be used to afford timely payment of progress payments to subcontractors working on construction projects in addition to ultimate payment. Payment bonds are not currently used to ensure timely payment of progress payments. The Miller Act requires a subcontractor that has not received ultimate payment to wait 90 days after completing the work before filing suit. To be an effective mechanism to ensure more timely payment of progress payments to subcontractors, the Miller Act would have to be amended to eliminate the requirement that subcontractors wait 90 days.

However, officials in the surety industry told us that if the waiting period was reduced or eliminated, so that subcontractors could request payment against payment bonds whenever a payment is overdue, the cost of payment bonds could increase. Sureties may conduct an investigation before making a payment under a payment bond. Officials in the surety industry told us that these additional investigations could be costly, in part, because they could require additional resources. In addition, any investigations requiring more than minimal scrutiny would negate the timeliness of payments under the payment bond.

Payment Bonds to Equal Contract Value

Section 806 lists as an option for consideration that payment bond amounts required under the Miller Act be increased from the current maximum amounts to an amount equal to 100 percent of the contract amount. This would provide additional payment protection to subcontractors when the current required maximum value is not sufficient to cover subcontractor claims.

In accordance with the Miller Act, a payment bond is currently limited to (1) 50 percent of the contract price if the price does not exceed $1 million, (2) 40 percent of the contract price if the price is between $1 million and $5 million, or (3) $2.5 million if the contract price is more than $5 million.

[2]A performance bond is a promise of a surety assuring the government that once the contract is awarded, the prospective contractor will perform its obligations under the contract.

Eliminating the current cap on payment bond amounts could affect the ability of prime contractors to obtain bonds. Some small disadvantaged contractors already experience difficulty in obtaining bonds partially due to their limited financial capability. The inability of these contractors to obtain bonding may restrict their ability to compete in government contracting.

Moreover, surety officials stated that existing bond coverage was sufficient to pay all subcontractors except in infrequent circumstances. Ordinarily, the prime contractor is required to perform a small percentage of the total work with its own forces.

Payment Bonds on Supply and Service Contracts

Section 806 lists as an option for consideration that payment bonds be used for supply and service contracts. Federal regulations currently specify that, in general, bonds shall not be required on supply and service contracts. However, under certain circumstances, contracting officers can require their use. Requiring the use of payment bonds on all supply and service contracts would increase contract costs. Surety officials stated that bonds typically cost about 1 percent or more of the contract value.

Government procurement and surety industry officials indicated that certain contracts could be difficult to bond. As stated earlier, some small disadvantaged contractors already experience difficulty in obtaining bonds due to their limited financial capacity. The inability of these prime contractors to obtain bonding may restrict their ability to compete in government contracting. Further, sureties may not want to bond experimental research and development contracts because these contracts do not have a definitive value.

Letters of Credit as Substitutes for Payment Bonds

Section 806 lists as an option for consideration that letters of credit be used as substitutes for payment bonds in providing protection to subcontractors on federal contracts. Construction prime contractors will have the option of substituting a letter of credit as security for the Miller Act payment bond. By using a letter of credit, a prime contractor does not have to qualify with a surety for bonding, while still protecting subcontractors against nonpayment. Substituting letters of credit as security for payment bonds is expected to improve access to federal procurement for small businesses that may have difficulty obtaining bonds from sureties.

As stated above, a payment bond is required only when a performance bond is required. If a contractor defaults or subcontractor payment problems arise, the government's role could be substantially greater with letters of credit than with bonds, according to an official at a large bank. A surety obligates itself to ensure contract completion, as well as to pay subcontractors, if the contractor it has bonded defaults. Conversely, a bank that has issued a letter of credit is not responsible for ensuring contract completion or confirming performance or payment problems, just for paying the beneficiary the amount of the letter of credit when the conditions of the letter are met. In this case, the government would be responsible for completing the contract if the contractor defaulted.

Conclusion

Various statutory and regulatory provisions provide payment protections for subcontractors working on federal projects. The items listed in section 806 could provide some additional payment protection but would add varying amounts of cost and administrative burdens to the payment process.

Better Use of Special Payment Protection Techniques Needed

We received 151 responses from subcontractors who complained about their payment problems on work funded by federal projects in fiscal year 1991 (their latest complete fiscal year). The identified payment problems were noteworthy to the responding subcontractors because they adversely impacted the firms' cash flow and financial health. However, the section 806 proposals would not always address the causes of the payment problems identified. Contracting officers currently have the authority to take action when subcontractor payments are not timely and have used most of the section 806 provisions on an ad hoc basis. However, federal policy and procedures do not clearly describe the circumstances under which contracting officers should take action to ensure timely payments to subcontractors.

Payment Problems Identified by 151 Subcontractors

Our questionnaire to obtain information from subcontractors about their payment problems was distributed through 33 contractor associations and other means. We received 151 responses from subcontractors who complained about their payment problems on work funded by federal projects in fiscal year 1991 (their latest complete fiscal year). Of the 151 subcontractors who complained to us about late payment, 118 reported the amounts of delayed payments. The delayed payments were estimated at $345 million, or about 23 percent of subcontract revenue, and the delays averaged 146 days from the time the subcontractors submitted their invoices to the prime contractors. In addition to identifying a payment problem, the subcontractors provided other information, in response to our questions, which is summarized below.

Financial Data on Delayed Payments

Of the 151 firms identifying payment problems, 118 provided an estimate of the amount of delayed payment. These firms earned revenue as prime contractors and subcontractors in the federal sector as well as from non-federal sources. As shown in table 3.1, the delayed payments were estimated at $345 million—about 23 percent of the firms' $1,519 million of their federal subcontract revenue and about 5 percent of their total revenue for fiscal year 1991.

Table 3.1: Sources of Fiscal Year 1991 Accrued Revenue for 118 Firms

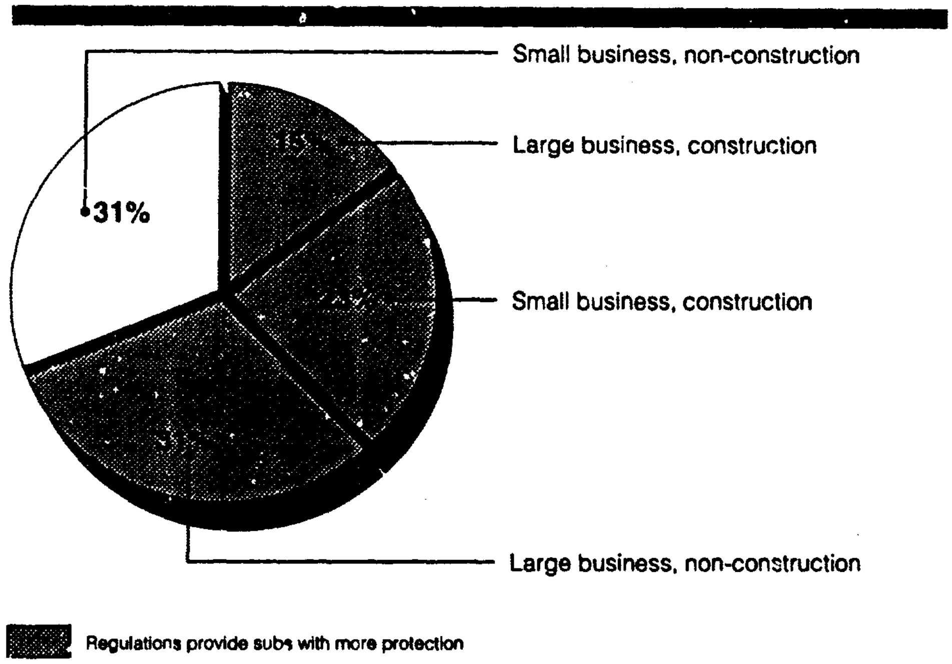
Dollars in millions

Revenue source in FY 1991	Amount
Prime on federal contract	$2,915
Subcontractor on federal contract	
Delayed payments	345
Non-delayed payments	1,174
Subtotal	1,519
Non-federal sources	2,145
Total	**$6,579**

Type of Prime Contractor

The subcontractors provided us with information on the type of prime contractor involved in their worst payment problem related to a federal contract. Figure 3.1 shows that about 70 percent of the subcontractors worked for prime contractors on their worst subcontractor payment problem who pay their subcontractors after receipt of payment from the government. These delayed payments were partially attributed to late payment by the federal government. About 30 percent of the subcontractors worked for primes that were expected to pay in advance of receiving payment from the government. These delayed payments can be due in part to the prime contractor challenging the subcontractor's request for payment.

Figure 3.1: Prime Contractors Causing Worst Payment Problems for Subcontractors That Complained to GAO



Actions Taken to Resolve Problem

The firms provided information about the actions they took to address their delayed payment problems. Almost all of the firms reported that they formally notified their contractor in writing that the payment was overdue (that is, sent past due notices). Forty percent reported that they requested assistance from a federal agency officer, such as a contracting officer, and 27 percent stopped work. For those firms that classified themselves as construction (less than 50 percent), 18 percent filed a notice under the Miller Act. About 8 percent reported that they collected interest under the terms of the subcontract.

Causes of Delayed Payment

In identifying the causes of their worst delayed payment problem, 20 out of 118 subcontractors that experienced a payment problem reported that the prime challenged their request for payment. Fifty-two of the 118 subcontractors reporting payment problems said that they believed a government delay in paying the prime contractor contributed to the subcontractors' payments being delayed.

Length of Payment Delay

For their worst late payment, the subcontractors that complained about payment problems provided the dates when they submitted their invoice to the prime and when they received payment. For those that had been paid, payments were made an average of about 146 days after the firms submitted their invoices to the prime contractor. However, about 41 of the 118 responding firms had not been paid on their most significant payment problem as of late 1992. Delays of this magnitude will adversely affect a subcontractor's cash flow and ultimately reduce its profitability.

Proposals Do Not Address Some of the Causes of Payment Problems

In examining the feasibility and desirability of the payment protections listed in section 806, we attempted to identify some of the underlying causes of payment problems. The items described in section 806 may help prevent prime contractors from diverting funds for purposes other than their intended use. However, the items listed in section 806 would not help mitigate payment problems caused by

- delayed payment by the government and/or
- disputes between the prime and the subcontractor.

When the government has delayed payment to the prime contractor, some of the payment protections listed in section 806 would not provide additional payment protection to subcontractors. Procurement officials stated that payment delays may result from the government not processing the prime contractor's payment request in a timely fashion. However, the payment delays may also result from the government disapproving the prime contractor's payment request because of contract performance problems.

In addition, many of the items listed in section 806 would provide additional payment protection to subcontractors only if the prime contractor has agreed to pay the subcontractor and certifies on its invoice to the government that the subcontractor should be paid. Procurement officials we interviewed said that disputes were a cause of subcontractor payment problems. When there is a dispute between the prime and the subcontractor, the prime may delay payment to the subcontractor until the dispute is resolved and the prime is expected to exclude these costs from its invoice to the government. The items listed in section 806 are not designed to address delayed payments to subcontractors that result from disputes.

Contracting Officers Can Provide Additional Payment Protection

The National Defense Authorization Act for Fiscal Years 1992 and 1993 requires DOD to disclose payment information about prime contracts and allows contracting officers to respond to subcontractor assertions of nonpayment. The act states that under procedures established in the regulations, when the prime contractor has not complied with subcontract payment terms, a contracting officer may encourage a prime contractor to make timely payment to the subcontractor; or reduce or suspend progress payments to the contractor if contract payment terms allow it. The act also authorizes the contracting officer to pursue administrative or legal action if the contractor's certification that accompanies a payment request is inaccurate.

In response to this act, DOD issued regulations that were effective in September 1992. Portions of the regulations require contracting officers to advise the subcontractor on whether the prime contractor has submitted requests for payments. Contracting officers are also required to disclose information about payment bonds to subcontractors. Subcontractors can use this information to help resolve their payment problems.

DOD's new regulations state that contracting officers may "encourage the contractor to make timely payment to the subcontractor . . ." As discussed in chapter 2, contracting officers have occasionally used special payment protection techniques to improve the timeliness of payments to subcontractors, such as special bank accounts. However, contracting officials expressed a reluctance to take actions even in cases where contract performance had seriously been affected or the contractor had repeatedly failed to make timely payment. DOD officials stated that its policies and procedures do not identify the (1) circumstances under which contracting officer should act and (2) special payment protection mechanisms that could be used.

Recommendation

Payment protection mechanisms, such as many of those listed in section 806, are available and could be used to improve the timeliness of payments to subcontractors. However, policy and procedures do not clearly state when a contracting officer should act and what actions should be taken when subcontractor payment problems are identified. We recommend that the Secretary of Defense issue policies and procedures for (1) identifying the circumstances under which contracting officers should take action to provide payment protection for subcontractors and (2) implementing appropriate payment protection techniques.

Comments and Our Evaluation

In commenting on a draft of this report, DOD concurred with our findings and partially concurred with our recommendation. DOD stated that it has a significant interest in the timely payment of subcontractors because of the potential negative impact on a prime contractor's performance when subcontractors are not paid promptly. DOD agreed to take action to ensure that contracting officers are aware of the special techniques to use when subcontractor payment problems arise. We believe that DOD's proposed actions are consistent with our recommendation. DOD's comments are presented in their entirety in appendix I.

We also requested comments on a draft of this report from selected industrial associations and have revised the report where appropriate. However, one of the criticisms indicated that we did not fulfill the requirements of section 806, in part, because we did not include an analysis of the appropriateness of any differential treatment for subcontractors needed in exploring the feasibility and desirability of the payment protections described in section 806. We considered the feasibility and desirability of providing additional payment protection for subcontractors working for different categories of prime contractors, as well as providing additional payment protection for all tiers of subcontractors. However, we concluded that since the payment problems identified were not specific to a particular group, there was not a need for providing differential treatment.

Other criticisms centered around the distribution of the questionnaire contained in appendix III, as well as the time provided to respond to the questionnaire. We have modified the report to emphasize that we did not use statistical sampling techniques and that the respondents were entirely self-selected. We had originally requested that all responses be returned by September 15, 1992. However, when we contacted each of the associations to ensure that they had received the questionnaire for distribution to their member firms, 10 of the 33 associations said they needed additional time to distribute the questionnaire; as a result, we continued to accept responses through November 1992.

Comments From the Department of Defense

OFFICE OF THE UNDER SECRETARY OF DEFENSE
WASHINGTON, DC 20301

ACQUISITION

MAR 2 3 1993

DP/CPF

Mr. Frank C. Conahan
Assistant Comptroller General
National Security and
International Affairs Division
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Conahan:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report entitled--"SUBCONTRACTOR PAYMENT: Need for Statutory and Regulatory Changes Not Identified," dated February 3, 1993 (GAO Code 396156/OSD Case 9314). The DoD concurs with the findings and partially concurs with the recommendation included in the report.

The DoD has a significant interest in the timely payment of subcontractors because of the potential negative impact on contract performance when subcontractors are not paid promptly. It is the DoD policy that prime contractors promptly pay their subcontractors for work performed on defense contracts. However, because contracts between prime contractors and subcontractors are private contracts, the DoD does not have privity of contract with the subcontractors and must, therefore, induce compliance through requirements placed on prime contractors.

For example, a DoD objective is to do business only with companies having a satisfactory record of integrity and business ethics. For that reason, a contracting officer is required to obtain information about a potential prime contractor's responsibility before awarding a contract. Responsibility includes the potential contractor's financial condition, performance record, and relations with vendors, trade creditors, and bankers. Companies which are not paying their bills promptly are regarded unfavorably during these reviews and may be prevented from receiving a contract.

Construction contracts require prime contractors to have a third party guarantee that subcontractors and suppliers on a DoD contract will be paid. The prime contractor must also certify that payments to subcontractors will be made within seven days of payment by the DoD, which ensures subcontractors on construction contracts are paid promptly.

Additionally, if the prime contractor is a large business, the DoD will not make progress payments or cost reimbursements on subcontracts until payment is made to the supplier. If any prime contractor (whether a large or small business) is delinquent in paying the costs of performing a defense contract, the Progress Payments clause gives the contracting officer the authority to suspend or reduce progress payments. These requirements are a strong incentive for timely payment to subcontractors.

In accordance with the requirements included in Section 806 of the National Defense Authorization Act for Fiscal Years 1992 and 1993 (Public Law 102-190), the DoD issued additional regulations that became effective in September 1992. These regulations require the DoD to disclose information about prime contract payments and payment bonds to subcontractors, to encourage prime contractors to make timely payments to subcontractors, and to consider reducing or suspending progress payments to contractors if allowed by the contract payment terms.

The DoD agrees that despite these policies, there are some problems with subcontractor payments, although the problems are not widespread. Contracting officers are reluctant to use special techniques that would encourage the prompt payment of subcontractors even when contract performance has been seriously affected. The DoD agrees that special techniques (such as special bank accounts, escrow accounts, and proofs of subcontractor payment) should be considered when contract performance is expected to be negatively impacted because of subcontractor payment problems.

To ensure contracting officers are aware of these techniques and the situations when they should be considered for use, the Director of Defense Procurement will issue a memorandum within the next 60 days to the Military Departments and the Defense Logistics Agency. The memorandum will address (1) the importance of examining company payment of subcontractors before issuing a responsibility determination for potential contractors; (2) the importance of communications between administrative contracting officers, procurement contracting officers, and prime contractors when subcontractor payment problems arise; and (3) the selective use of special techniques when the contracting officer believes contract performance may be jeopardized due to subcontractor payment problems. This policy memorandum will be highlighted in a Defense Acquisition Circular. The DoD will also ensure the subject is adequately covered in training courses and the Contract Administration Manual.

The detailed DoD comments on the report recommendation are provided in the enclosure. The DoD appreciates the opportunity to comment on this draft report.

Sincerely,

Eleanor Spector

Eleanor R. Spector
Director, Defense Procurement

Enclosure

GAO DRAFT REPORT--DATED FEBRUARY 3, 1993
(GAO CODE 396156) OSD CASE 9314

"SUBCONTRACTOR PAYMENT: NEED FOR STATUTORY AND
REGULATORY CHANGES NOT IDENTIFIED"

DEPARTMENT OF DEFENSE COMMENTS ON
THE GAO RECOMMENDATION

* * * * *

RECOMMENDATION

Now on p. 27

o **RECOMMENDATION**: The GAO recommended that the Secretary of Defense issue policies and procedures (1) for identifying the circumstances under which contracting officers should take action to provide payment protection for subcontractors and (2) for implementing appropriate payment protection techniques. (p. 33/GAO Draft Report)

DOD RESPONSE: Partially concur. The Director of Defense Procurement will issue a policy memorandum within the next 60 days to the Military Departments and the Defense Logistics Agency to ensure contracting officers are aware of the payment techniques available for use when the interests of the Government need protection due to subcontractor payment problems. The memorandum will address (1) the importance of examining company payment of subcontractors before issuing a responsibility determination for potential contractors; (2) the importance of communications between administrative contracting officers, procurement contracting officers, and prime contractors when subcontractor payment problems arise; (3) and the selective use of special techniques when the contracting officers believe contract performance may be jeopardized due to subcontractor payment problems. In addition, the Department will ensure that this subject area is adequately covered in training courses, and that the issuance of the policy memorandum is highlighted in a Defense Acquisition Circular. Since many of these problems arise on contracts under the cognizance of the Defense Contract Management Command, the substance of the policy memorandum will be included in the Contact Administration Manual issued by the Defense Logistics Agency. The Department expects to implement the above actions in FY 1993.

Enclosure

Executive Branch Activities and Locations Visited

Department of Defense

Office of the Secretary of Defense, Director of Defense Procurement

Defense Contract Audit Agency
- Headquarters
- Branch offices (Atlanta, Orlando)

Defense Contract Management Command
- Headquarters
- Defense Contract Management Command District South
- Defense Contract Management Area Operations (Atlanta, Birmingham, Chicago, Orlando)

U.S. Air Force, Warner-Robins Air Logistics Center

U.S. Army Corp of Engineers
- Headquarters
- South Atlantic Division
  - Savannah District
  - Mobile District

U.S. Army Missile Command

Naval Facilities Engineering Command
- Headquarters
- Northern Division (Philadelphia)

Naval Sea Systems Command
- Headquarters
- Supervisor of Shipbuilding, Conversion, and Repair (New Orleans)

Office of Management and Budget

Office of Federal Procurement Policy

Small Business Administration

Offices of Advocacy, Minority Small Business and Capital Ownership Development, Procurement Assistance, and Surety Guarantees

GAO Questionnaire on Subcontractor Payment Problems

REQUEST FOR INFORMATION ABOUT DELAYED PAYMENT PROBLEMS
FOR SUBCONTRACTORS UNDER FEDERAL CONTRACTS IN 1991

The United States General Accounting Office (GAO), an agency of the Congress, is studying subcontractor payment procedures as part of a congressional assessment of federal contracting legislation. Part of our study concerns delays which subcontractors have experienced in receiving payments from contractors on work funded by federal contracts. If you have had a *delayed payment*, as defined below, we encourage you to complete this questionnaire. Information provided in the questionnaire will be treated as confidential by GAO. Study results will only be reported in statistical summaries in which the information from individual firms can not be identified.

Completed questionnaires should be returned to:
Mr. Ralph Dawn
US General Accounting Office
Room 5015
441 G Street NW
Washington, D.C. 20548

Any inquiries about the study should be directed to Mr. Ralph Dawn or Ms. Edna Falk (202-275-8465).

DEFINITION OF *DELAYED PAYMENTS* WHICH ARE ELIGIBLE FOR THIS STUDY

Return this questionnaire ONLY if you answer "YES" to these three questions. *(Mark the correct answers)*	Eligible (1)	Not eligible (2)
a. Were you a subcontractor, supplier, or materialman in Fiscal Year 1991 (your firm's FY-91) on at least one subcontract that is funded by a federal contract?	○ Yes	○ No
b. Were you owed payments at any time in FY-91 on such a contract?	○ Yes	○ No
c. Was the payment on at least one such subcontract delayed beyond a period which was either specified in your subcontract, identified as your due date or accepted as normal for these types of contracts?	○ Yes	○ No

DEFINITION OF TERMS:

Accrued revenue: revenue earned in a period without regard to the timing of related cash receipts.
Subcontractor: This includes suppliers and materialmen as well as other subcontractors.
Small Disadvantaged Business Concern: a firm which is eligible for the Small Business Administration's 8(a) program established by Section 8(a) of the Small Business Act, 15 U.S.C. 637(a) and defined in Federal Acquisition Regulation (FAR) 19.001.
Small Business Concern: a Small Business Concern as defined in 13 CFR Part 121, incorporated in FAR 19.102
Commercial product: an item, material, component, subsystem, or system, sold or traded to the general public in the course of normal business operations at prices based on established catalog or market prices (FAR 11.001).

PART A: BACKGROUND ON YOUR FIRM

1 What is the complete name of your organization? (If you are reporting for only a part of a larger company, please also specify the division name.)

____

2 Whom should we contact if we have further questions or need to request supporting documentation?
Name: _______________
Position: _______________
Telephone: ( ) _______________
Date: _______________

3 Was most of your firm's FY-91 income from work classified as construction? *(Mark the correct answer.)*
1 ○ Yes
2 ○ No

4 How is your firm classified by federal regulations? [NOTE: Terms are defined at the beginning of the questionnaire]
1 ○ Small, Disadvantaged Business (Section 8a)
2 ○ Other Small Business Concern
3 ○ Other business (large)

PART B: FINANCIAL DATA FOR YOUR FISCAL YEAR 1991
(Use your firm's Fiscal Year 1991 in this questionnaire. Accrued revenue is defined above.)

5 Divide your total FY-91 revenue between amounts
$________ Accrued as prime contractor on federal contracts
$________ Accrued as a subcontractor on federal contracts
$________ All other sources
$________ TOTAL (FY-91 Total gross revenue)

Page 1 of 7

6 Please divide the total value of the *delayed payments* (i.e. aging receivables) for income accrued in FY-91 as a subcontractor on federal contracts between the following: (51-72)

$_____ Aged receivables--payment still NOT received
$_____ Aged receivables--payment received

7 Approximately how much of your Total Gross Revenue in FY-91 was from sales of "commercial products" on federal contracts or subcontracts? (Enter "0" if none) [NOTE: "Commercial product" is defined at the beginning of the questionnaire.] (73-80)

$_____

8 Please check (✓) all of the following actions, if any, which your firm has ever taken to obtain any of your FY-91 *delayed payments* on a subcontract supported by a federal contract. (Check ✓ all that apply)

_ Formally notified your contractor in writing that the payment was overdue (e.g. sent past-due notice)
_ Requested federal agency officer to assist in obtaining payment from your contractor
_ Filed a notice under the Miller Act (Construction only)
_ Filed a suit in court
_ Sought resolution through arbitration or mediation
_ Stopped work with contractual authority
_ Stopped work with<u>out</u> contractual authority
_ Collected interest under the terms of your subcontract
_ Other (Please describe) _____
_ Not taken any action

PART C: MOST SEVERE SUBCONTRACTOR *DELAYED PAYMENT* PROBLEM IN FY-91

NOTE: This section concerns ONLY the <u>single</u> FY-91 *delayed payment* subcontract which had the greatest financial impact on your firm in FY-91 and was funded by a federal contract.

9 What was the award date for the single <u>sub</u>contract (funded by a federal contract) with the *delayed payment* problem which had the greatest financial impact on your firm in FY-91? (16-21)

___ ___ ___
(Month) (Day) (Year)

10 What was your position on this subcontract in relation to the federal prime contractor? (34)
1 ◯ 1st tier subcontractor
2 ◯ Other tier (Specify) _____
3 ◯ Not known

11 Is this subcontract supporting a single federal contract, multiple federal contracts, both federal and non-federal contracts, or don't you know? (35)
1 ◯ Single federal contract ⇒ What is the federal government prime contract number (if known)?

_____

2 ◯ Multiple federal contracts
3 ◯ Both federal and non-federal contracts
4 ◯ Not known

12 Was the major federal prime contract in the previous question classified as a construction contract? (36)
1 ◯ Yes
2 ◯ No
3 ◯ Don't know

13 What is the complete name of the firm to which you were a subcontractor for this work (i.e. Question #9 subcontract)? (If it is a part of a larger company, please specify the company and division name.)

_____

14 How is the firm in the previous question classified by federal regulations? [Terms are defined on page 1.]
1 ◯ Small, Disadvantaged Business (Section 8a)
2 ◯ Other Small Business Concern
3 ◯ Other business (large)

15 Please divide all invoices/requisitions submitted during this subcontract (from start date of contract through end of FY-91) by payment status. (Approximate values are adequate)

PAYMENT RECEIVED:
$_____ Delayed (received after due date)
$_____ Not delayed (received by due date)

PAYMENT NOT RECEIVED:
$_____ Delayed (not received by due date)
$_____ <u>Not delayed (not yet reached due date)</u>
_____ TOTAL (ALL invoices submitted from beginning of contract to end of FY-91)

PART D: CHRONOLOGY FOR A SINGLE DELAYED PAYMENT

NOTE: This section concerns ONLY the single most important *delayed payment* (i.e. SINGLE invoice or requisition) under the subcontract (i.e. Question #9 subcontract) which had the greatest financial impact on your firm in FY-91.

16 Provide the following dates for the single most important *delayed payment* (i.e. single invoice or requisition) under this subcontract (i.e. Question #9 subcontract) *(Check "Do not know" if date is not known.)*		Date: Month	Day	Year	Do not know (✓)
a. Submission of your invoice/requisition (8-14)				19__	
[Answer Question "b." if you are a 2nd tier or lower subcontractor ⇒]	b. Payment received by your immediate contractor (Approximate date. If unknown check ✓ "Do not know".) (15-21)			19__	
c. Date from which you considered the payment to be *delayed* (i.e. beginning of *delayed payment* period) (22-28)				19__	
d. Payment received by you (If not received, write "outstanding".) (29-35)				19__	

17 Was the date from which you considered the payment to be delayed in Question 16.c determined by... (36-39)	*(Check correct answer)*	
a. Payment terms specified in your subcontract	1 ◯ Yes	2 ◯ No
b. Payment terms specified on your invoice/purchase order	1 ◯ Yes	2 ◯ No
c. Customary practices in your industry	1 ◯ Yes	2 ◯ No
d. Other (Describe) ____________________	1 ◯ Yes	2 ◯ No

18 At the time of the delay, was your request for payment challenged by your contractor? (40)
1 ◯ Yes
2 ◯ No

19 Has the prime contractor received payment from the federal government for that single invoice/requisition?
1 ◯ Yes⇒ Approximately when did the prime contractor receive payment (if known)? ____________ (Month/Day/Year) (41-47)
2 ◯ No
3 ◯ Do not know

20 To what extent, if at all, was a delay by the government in paying the prime contractor responsible for your payment being delayed? (48)
1 ◯ totally
2 ◯ almost totally
3 ◯ partially
4 ◯ slightly
5 ◯ not at all

PART E: EVALUATIONS OF PROPOSED PROVISIONS CONCERNING SUBCONTRACTOR RELATIONSHIPS

DIRECTIONS: Please answer Questions 21 and 22 for each of the possible payment protection provisions described below. Possible payment protection provisions which GAO was asked by the Congress to evaluate.	QUESTION 21 Would this have prevented or resolved the *delayed payment* problem described in Question 16?			QUESTION 22 Would you favor, conditionally favor or oppose applying this provision to your contracts and subcontracts? (*If "Conditionally favor", Please describe conditions*)			
PART I: QUESTIONS FOR ALL	(1)	(2)	(3)	(1)	(2)	(3)	(4)
i. ***For periodic and progress payment contracts:*** the prime contractor must establish an escrow account and require disbursements by the escrow agent to subcontractors of amounts certified by the prime contractor in invoices to the federal government a being payable to such subcontractors (29-30)	◯ Yes	◯ No	◯ Not known	◯ Favor	◯ Conditionally favor (Describe)	◯ Oppose	◯ Not known
ii. ***For periodic and progress payment contracts, if a government contracting officer determines the prime is repeatedly not making timely payments:*** a method must be established for direct disbursements to subcontractors of amounts certified by the prime contractor in invoices to the federal government as being payable to such subcontractors (31-32)	◯ Yes	◯ No	◯ Not known	◯ Favor	◯ Conditionally favor (Describe)	◯ Oppose	◯ Not known
iii. Prime contractor must furnish or provide payment bonds to ensure TIMELY and ultimate payment to subcontractors (33-34)	◯ Yes	◯ No	◯ Not known	◯ Favor	◯ Conditionally favor (Describe)	◯ Oppose	◯ Not known
iv. Prime contractor may substitute letters of credit in instances in which payment bonds are required (35-36)	◯ Yes	◯ No	◯ Not known	◯ Favor	◯ Conditionally favor (describe)	◯ Oppose	◯ Not known
PART II: QUESTIONS FOR PERIODIC OR PROGRESS PAYMENT, NON-CONSTRUCTION CONTRACTS							
v. Prime contractor must: (i)include a clause in subcontracts requiring payment to subcontractors within a fixed time period after receiving payment from the government, and (2) certify with each invoice to the government that past payments have been made to the subcontractor on time and that payments under this invoice will be on time (37-38)	◯ Yes	◯ No	◯ Not known	◯ Favor	◯ Conditionally favor (Describe)	◯ Oppose	◯ Not known
PREPAYMENT REQUIRED vi. Prime contractor must have paid and submitted proof of payments to subcontractors before invoicing the government for those payments (39-40)	◯ Yes	◯ No	◯ Not known	◯ Favor	◯ Conditionally favor (Describe)	◯ Oppose	◯ Not known
PART III: QUESTION FOR CONSTRUCTION CONTRACTS							
vii. ***If payment bonds are now required under the Miller Act:*** a prime contractor must increase the bond to 100% of the amount of the contract (41-42)	◯ Yes	◯ No	◯ Not known	◯ Favor	◯ Conditionally favor (Describe)	◯ Oppose	◯ Not known

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Trade Associations Distributing Questionnaire

Aerospace Industries Association
American Apparel Contractors Association, Inc.
American Association of Black Women Entrepreneurs
American Consulting Engineers Council
American Council of Independent Laboratories, Inc.
American Electronics Association
American Indian Council of Architects and Engineers
American Insurance Association
American Subcontractors Association
Associated Builders and Contractors, Inc.
Computer and Business Equipment Manufacturers
Contract Services Association of America
Electronic Industries Association
Information Technology Association of America
International Communication Industries Association
Latin American Management Association
Manufacturer's Alliance for Productivity and Innovation, Inc.
Mechanical Contractors Association of America, Inc.
Minority and Women Owned Businesses
National Association of Credit Management
National Association of Minority Business
National Association of Minority Contractors
National Center for American Indian Enterprise Development
National Electrical Contractors Association
National Minority Supplier Development Council
National Moving and Storage Association
National Roofing Contractors Association
National Security Industrial Association
National Small Business United
National Tooling and Machining Association
National Truck Equipment Association
Professional Services Council
Small Business Legislative Council

Statutory and Regulatory Provisions to Help Ensure Payments to Subcontractors

The table describes statutory and regulatory provisions that help to ensure subcontractors are paid by prime contractors for work performed under federal contracts.

Statute	Regulations	Description of provision (Report page no. reference)
10 U.S.C.[a] 2301 note	48 C.F.R.[b] 228.106, 232.970, 252.228-7006	DOD is required to disclose certain payment information about prime contracts to subcontractors. DOD prime contractors are required to provide a copy of the payment bond to a prospective subcontractor upon request. DOD contracting officers may determine whether the prime contractor has made payments in compliance with subcontract terms when a subcontractor asserts that it has not been paid. (p. 27)
15 U.S.C. 636(j)	48 C.F.R. 124.305	The Small Business Administration, under a pilot program, requires use of a special bank account or direct disbursement to protect payments to subcontractors when it has waived bonding requirements for construction contracts. (p. 19)
15 U.S.C. 636 note	48 C.F.R. 219.8, 252.219-7007	DOD, under a test program, requires the contractor to establish a special bank account before award to ensure protection of all subcontractors when DOD has waived Miller Act requirements for performance and payment bonds for small disadvantaged business concerns that have not been able to obtain bonds.
15 U.S.C. 637(c)	48 C.F.R. 19.702, 19.704, 19.708, 52.219-8	A statement is required in contracts that it is U.S. policy that its prime contractors establish procedures to ensure the timely payment of amounts due to small business subcontractors.
15 U.S.C. 644(k)	Not incorporated into C.F.R.	Federal Offices of Small and Disadvantaged Business Utilization are responsible for helping small business subcontractors obtain payment, required late payment interest penalties, or information regarding payments due to them in accordance with protections in the Federal Acquisition Regulation or agency supplements.
31 U.S.C. 3903	48 C.F.R. 52.232-5, 532.905-70, 852.236-82, 852.236-83 OMB[c] Circular A-125 Section 5d	Construction prime contractors must certify with each payment request that payments to subcontractors have been made and timely payments will be made. (p. 15)
31 U.S.C. 3903	OMB Circular A-125 Section 5d	Federal agencies must obtain detailed information from construction prime contractors on amounts owed and paid to subcontractors as substantiation with each request for payment. (p. 15)
31 U.S.C. 3903	48 C.F.R. 52.232-5	Construction prime contractors must substantiate the payment amount requested. (p. 15)
31 U.S.C. 3905	48 C.F.R. 52.232-27	Construction prime contractors must pay subcontractors for satisfactory performance within 7 days of receiving payment from the government or pay interest on amounts due when paid late. This requirement also applies for all tiers of subcontractors working under a federal construction contract. (p. 15)

(continued)

Statute	Regulations	Description of provision (Report page no. reference)
40 U.S.C. 270(a)-270 (f)	48 C.F.R. 28.1	Contractors on federal construction contracts exceeding $25,000 must furnish performance and payment bonds. Bonds may be used for other than construction contracts if circumstances warrant their use. (p. 19)
	48 C.F.R. 9.1, 32.1, 32.5, 42.3, 44.3, 52.216-7	The government conducts preaward surveys of prime contractor qualifications and audits after paying them. (p. 13)
	48 C.F.R. 32.1, 32.5	Contracting officers may use non-standard protective terms when contractors are receiving interim payments and circumstances warrant their use. (p. 23)
	48 C.F.R. 52.216-7, 52.216-26, 52.232-7, 52.232-16	Payment clauses used with either fixed-price or cost-reimbursement contracts require large businesses receiving contract financing payments to pay their subcontractors before billing the government for those costs. (pp. 8,15)
	48 C.F.R. 53.301-1443	A business concern with a fixed-price non-construction contract receiving progress payments based on costs must certify with each payment request to the government that it is paying all the costs of contract performance when due. (p. 16)

[a]United States Code.

[b]Code of Federal Regulations.

[c]Office of Management and Budget.

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